DANN ASSET ADVISORS, LLC

Third Quarter 2013 Update

October 14, 2013

3Q13 Highlights

- U.S. economy continues to grow slowly and fitfully
- Europe as a whole appears to have bottomed
- International stock markets outperform the U.S.
- Bond markets stabilize as Fed determines not to reduce bond purchases
- Congressional action on spending and the debt ceiling is the key near term wild card

Markets

The table below summarizes the performance of some key indices during the third quarter and year to date:

Market Performance		
Index	% Ch. 3Q13	% Ch. YTD
S&P 500	5.2	19.8
MSCI Developed Markets (excl N Am)	11.6	16.1
MSCI Emerging Markets	5.8	-4.4
MSCI All Country World	7.9	14.4
US Aggregate Bond (1)	0.6	-1.9
Liquid High Yield (1)	2.3	2.5
US Dollar Emerging Markets Bond (1)	1.1	-7.7

(1) Barclays indices

Equities. The U.S. market (as measured by the large cap S&P 500 index) returned 5.2% for the quarter, bringing the year to date gain to just under 20%. Factors impacting the quarter included Federal Reserve actions, the possibility of a U.S. attack on Syria and, late in the quarter, the temporary government shut down that began October 1. Despite short term volatility caused by political and international events, we believe it's important to remain focused on the longer term. Through September 30, the S&P 500 had gained roughly 150% from the lows of March 2009. The index currently is trading at 14.6x anticipated 2014 earnings.

After a rough second quarter (especially for emerging markets), international markets rebounded in the third quarter. Developed Europe in particular had a strong quarter, gaining 13.8%, as economic numbers continued to indicate stabilization in many local economies. Although performance varied among different emerging markets, as a group this sector also rebounded in response, we believe, to better reported economic numbers from China.

Fixed income. Longer term U.S. bonds, as measured by the 10 year Treasury, continued to be volatile during the third quarter. The yield on the 10 year bond briefly touched 3% early in September (this last occurred in mid 2011) before retreating to roughly 2.6% at quarter end as the Fed decided not (yet) to begin reducing the size of its bond purchases.

Other sectors of the bond market – high yield and emerging market debt – also rallied into quarter end as the Fed decided not to taper. To us, the bond market's volatility in response to Fed actions indicates some continued speculation in longer duration bonds where we feel the risk/reward

90 Riverside Drive, Ste. 4D · New York, NY 10024 | T. 917.575.5307 | F. 646.304.3017 | www.dannasset.com

tradeoff remains unfavorable. While the fourth quarter may bring improvement, based on year to date results the Barclays U.S. Aggregate Bond index is on track for its first negative annual return since inception in 2003.

Portfolio Positioning

With actions taken during the third quarter the fixed income component of most diversified (fixed income and equities) portfolios are more than 80% in domestic investment grade securities with durations under three years – the substantial majority of this is in corporate and municipal securities, with only a small portion in U.S. government debt. During the quarter we scaled back what already were small positions in intermediate term investment grade bond funds and also reduced exposure to an actively managed, short duration global bond fund.

We've mentioned the global bond fund in prior updates, and it continues to be managed in what we judge to be an intelligent manner. As of quarter end, this fund had a 1.6 year duration and was 75%+ and 50%+ in investment grade and U.S. dollar denominated debt, respectively. We had thought that with this type of profile the fund would hold up reasonably well in a downturn. However, when the Fed first broached the idea of tapering in June, significant money seemed to leave emerging markets with the result that the fund declined more than we'd anticipated. While still liking the investment for the long term, we felt it prudent to reduce risk and thus sold a portion of the position.

Our belief, mentioned in our last update, that longer term U.S. interest rates had risen too much from mid-May into July proved accurate (for now, at least) as rates have come back down a bit. Still, taking the Fed at its word, any improvement in the U.S. economy from current levels likely will lead to the Fed being less accommodative and rates rising. However, from here, we expect any increase in rates to be much more gradual than occurred from mid-May into July.

With respect to equities, the best performing broad U.S. market sectors during the third quarter were materials, industrials and technology companies. In general, each of these sectors depends on positive worldwide economic growth (many of the large companies in these sectors have substantial international operations) to generate good earnings. While growth worldwide still is slow, stocks tend to anticipate future results and we believe these sectors performed well as improved industrial production and manufacturing in Europe, the U.S. and China indicated that growth may accelerate in upcoming months (assuming the U.S. government gets its act together).

In contrast, the three worst performing sectors were real estate investment trusts, utilities and consumer staples companies. Each of these sectors, especially the first two, are owned in part because of their dividend yields and often come under pressure when interest rates rise. Consumer staples had been one of the better performing sectors during the first half of 2013; its relatively poor third quarter performance may have been due in part to consumers allocating more spending to big ticket items (cars, home improvement).

During the first half of 2013 we were finding more value in cyclical as compared with more stable market sectors and stocks. On the whole, this continued during the third quarter although by quarter end, with the U.S. market up another 5%, it was more difficult to find good values. As a result, we ended the quarter with 10%-12% in cash in most equity-only accounts. Securities purchased for many clients during the quarter included a technology consulting company, an industrial filters manufacturer, a distributor of dental and veterinary supplies and an exchange traded fund focused on manufacturing/industrial companies.

Finally, as the fourth quarter began, Congress had failed to pass a budget and certain "non-essential" portions of the federal government were closed. This issue since has blended into the debt ceiling and the possibility that the U.S., without an increase in the amount of debt it can offer, may default on some of its obligations. We have no special insight into how these issues will play out, and for now are assuming that some type of resolution will be reached so that significant damage to the economy is avoided. If a resolution is not reached soon, there likely will be at least short term negative impacts for the economy, markets and the equity component of client portfolios.

Economy

The U.S. economy grew at a stronger than expected 2.5% pace in the second quarter (following 1.1% in the first quarter) and is estimated to have expanded at a 1.5%-2.0% rate in the just-ended third quarter. Relative to the second quarter, third quarter growth may be softer due to the rise in interest rates following the Fed's June announcement that it might reduce the amount of debt securities it's been purchasing. Of note, several large retailers mentioned sales being below plan in late summer. On the other hand, at least early in the third quarter, spending on big-ticket items had been strong.

On September 18, the Fed surprised the markets by not reducing the size of debt purchases (which in essence provide liquidity to the markets and, in theory, the economy) and since then rates have come back down. In our second-quarter update we wrote that "[t]he Fed also clearly stated that if the economy does not show improvement as expected, it will continue to purchase bonds and actually could increase the pace from the current $85 billion per month if needed." The bottom line, to us, is that the Fed became concerned during the third quarter that economic growth had at least temporarily slowed (even though the numbers have not been bad). The Fed also telegraphed its concern about the impact of what then was the potential (now reality) for a budgetary and debt ceiling impasse.

We have seen estimates that for each week the government is shut down, GDP growth is reduced by 0.1%-0.2%, although if the impasse is resolved quickly any current reduction could be made up by quarter end. Based on outcomes over the past several years, we are assuming that some type of agreement – on both spending and the debt ceiling – will be achieved before serious damage is done to the U.S. economy and/or confidence in the country's ability to repay its debt. Absent potential damage from the government, our feeling is that the U.S. economy is on reasonably solid ground and that slow growth in the 2% range will continue over the near term and potentially accelerate a bit in 2014. However, it's worth noting that debt ceiling issues and the uncertainty they created in summer 2011 did in fact hold back the economy in the third quarter of that year.

With respect to other economies, third quarter numbers generally have reinforced our feeling that Europe as a whole has stabilized and is moving toward slow growth. China's numbers have strengthened but may not be sustainable at current rates. And economic stimulus in Japan currently seems to be having the intended positive impact.

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